National Association
of Independent Insurers
2600 River Road, Des Plaines, IL 60018-3286

# Statement of the National Association of Independent Insurers to the Commissioner of Financial and Insurance Services Regarding the Use of Credit Information by Personal Lines Insurers

The National Association of Independent Insurers (NAII) is a property/casualty insurance trade association with more than 690 member insurance companies. NAII member companies are responsible for 53.3% of the personal lines premium volume written in Michigan. The number of NAII member companies domiciled in Michigan totals 22. The mission of NAII is to influence public policy to foster a competitive insurance marketplace, promote the successful operation of NAII members and enhance the welfare of their customers.

The business of insurance is all about risk. In deciding whether to provide or renew coverage for homes or cars, an insurer has to make some educated guesses about a number of things. How likely is it that the insured will be involved in an auto accident? How likely is it that their house will catch fire? In order to honor its obligations to all its policyholders, the insurer has to be as certain as possible that it has enough reserves to pay all the claims that are likely to be presented to it in a given period. Among other things, that means charging people for insurance coverage according to the risk they represent. An individual's credit history bears a relationship to the likelihood of claims being filed.

Some insurers use a tool called an insurance score to predict future insurance losses. An insurance score is developed from a mathematical model that weighs and measures credit information such as the number of collections, bankruptcies, outstanding debt, length of credit history, types of credit in use and the number of new applications for credit. These factors identify credit management patterns that have been proven to correlate with the probability of an insurance loss. The practice of using insurance scores as a factor in insurance underwriting and rating is now very common.

**History**

Although the use of credit information is new for some insurers, the practice has been permitted since 1970 when the U.S. Congress passed the Fair Credit Reporting Act (FCRA).

Insurers are interested in having available as many tools as possible to assist them in making a fair and objective decision about whom to insure and at what rate. Insurance scores provide insurers another tool to use in making fair and objective rating decisions. Most companies use insurance scoring as just one of several factors. It provides insurers with an objective tool for decision-making that evaluates risk and allocates the cost of coverage based on a consumer's claim potential.

Independent studies have proven a strong connection between insurance scores and the likelihood of an individual filing a claim. A Tillinghast-Towers Perrin study demonstrated that there was a 99 percent probability of a relationship between a person's insurance score and likelihood of that person having a claim.

Studies by Arthur Andersen and the Insurance Research Council show that credit reports are more reliable than motor vehicle records. In addition, consumers have a clearly defined review process to ensure the accuracy of their credit report.

In January 2000, the Virginia Bureau of Insurance released a study that concluded that insurance scoring is an accurate predictor to assess insurance risks and that the use of credit information does not discriminate based on income, race or other demographics.

**Rationale**

Most people have good credit and can benefit from insurance scoring. It can help consumers qualify for lower insurance rates and in some cases, even offset a less than perfect driving record. The use of insurance scoring helps insurers allocate the cost of insurance more fairly and prevent people who pose less risk from subsidizing high-risk policyholders. Insurance scores do not discriminate against any specific group of customers. They avoid subjective value judgments because the information is based solely on credit-related material. The development of an insurance score only takes into account credit-related information and does not consider race, gender, religion, marital status, income and birthplace.

Insurance scores have no relationship to a person's income. They provide an indication as to how responsibly a person manages whatever amount of income he or she makes. Insurance scores of people in lower income levels are virtually the same as those in higher income groups. Insurance scores do not differ from one ethnic group to another, or people living in one neighborhood to another. The scores are totally objective.

One NAII member found that using insurance scores enables it to charge 70 percent of its customers lower premiums. Other NAII members confirm that the use of credit has allowed them to write more business in urban areas.

Insurers do not use insurance scores to determine a person's ability to pay premiums. Insurance companies use an insurance score to assess an individual's insurance risk at a particular point in time. The score is developed from specific credit information and reflects financial management patterns such as collections, bankruptcies, outstanding debt, length of credit history, types of credit in use and the number of new applications for credit.

People who do not responsibly manage their credit are more willing to take the risks that cause losses. Those less likely to have a loss should not have to subsidize those people who engage in more risky behavior. Using credit is simply fair and beneficial to insurance consumers.

Insurance scores help insurers make more accurate rating decisions. Applicants and policyholders who are financially stable can enjoy lower premiums, while those who are less stable pay a premium that better reflects the risk they represent. The ability of insurers to make sound rating decisions also helps keep the insurance marketplace competitive.

Michigan is currently one of the most restrictive states when it comes to insurers' use of credit scores. Michigan's insurers can not use credit for underwriting decisions even though most other states do permit it. And in rating, Michigan insurers can only use credit to discount premiums. Is it good public policy to take this potential discount away from consumers?

Banning the use of credit for rating purposes would truly be a disservice to Michigan consumers by forcing good risks to subsidize bad risks. Michigan insurers merely desire to charge policyholders the appropriate amount for the risk they represent. It has been proven time and again by insurers data analysis as well as independent studies that an individual's credit history bears a relationship to the likelihood of claims being filed. There have been extensive studies on risk taking behavior and the correlation is solid.